UNIVERSAL HEALTH REALTY INCOME TRUST
Form 10-Q
November 06, 2015

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

(MARK ONE)

x QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the quarterly period ended September 30, 2015

OR

o TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the transition period from to

Commission file number 1-9321

UNIVERSAL HEALTH REALTY INCOME TRUST

(Exact name of registrant as specified in its charter)

MARYLAND	23-6858580
(State or other jurisdiction of	(I. R. S. Employer
incorporation or organization)	Identification No.)

UNIVERSAL CORPORATE CENTER

367 SOUTH GULPH ROAD

KING OF PRUSSIA, PENNSYLVANIA 19406

(Address of principal executive offices) (Zip Code)

Registrant's telephone number, including area code (610) 265-0688

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes x No o

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes x No o

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of "large accelerated filer," "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act.

Large accelerated filer	o	Accelerated Filer	x
Non-accelerated filer	o	Smaller reporting company	o

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes o No x

Number of common shares of beneficial interest outstanding at October 31, 2015—13,325,893

UNIVERSAL HEALTH REALTY INCOME TRUST

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This Quarterly Report on Form 10-Q is for the quarter ended September 30, 2015. In this Quarterly Report, "we," "us," "our" and the "Trust" refer to Universal Health Realty Income Trust and its subsidiaries.

As disclosed in this Quarterly Report, including in Part I, Item 1.—Relationship with Universal Health Services, Inc. ("UHS") and Related Party Transactions, a wholly-owned subsidiary of UHS (UHS of Delaware, Inc.) serves as our Advisor pursuant to the terms of an annually renewable Advisory Agreement dated December 24, 1986. Our officers are all employees of UHS through its wholly-owned subsidiary, UHS of Delaware, Inc. In addition, three of our hospital facilities are leased to subsidiaries of UHS and thirteen medical office buildings and two free-standing emergency departments, that are either wholly or jointly-owned by us, include tenants which are subsidiaries of UHS. Any reference to "UHS" or "UHS facilities" in this report is referring to Universal Health Services, Inc.'s subsidiaries, including UHS of Delaware, Inc.

In this Quarterly Report, the term "revenues" does not include the revenues of the unconsolidated limited liability companies ("LLCs") in which we have various non-controlling equity interests ranging from 33% to 95%. We currently account for our share of the income/loss from these investments by the equity method (see Note 5 to the Consolidated Financial Statements included herein).

Part I. Financial Information

Item I. Financial Statements

Universal Health Realty Income Trust

Condensed Consolidated Statements of Income

For the Three and Nine Months Ended September 30, 2015 and 2014

(amounts in thousands, except per share amounts)

(unaudited)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2015	2014	2015	2014
Revenues:				
Base rental - UHS facilities	$4,019	$3,864	$11,916	$11,694
Base rental - Non-related parties	8,763	8,235	26,438	22,506
Bonus rental - UHS facilities	1,085	1,157	3,453	3,529
Tenant reimbursements and other - Non-related parties	1,620	1,804	5,523	5,585
Tenant reimbursements and other - UHS facilities	199	198	607	549
	15,686	15,258	47,937	43,863
Expenses:				
Depreciation and amortization	5,424	5,247	16,817	14,855
Advisory fees to UHS	708	653	2,067	1,883
Other operating expenses	4,461	4,462	13,921	12,529
Transaction costs	-	198	204	301
	10,593	10,560	33,009	29,568
Income before equity in income of unconsolidated limited liability companies ("LLCs"), interest expense and gains	5,093	4,698	14,928	14,295
Equity in income of unconsolidated LLCs	561	499	1,826	1,771
Gain on property exchange	-	-	8,742	-
Gains on fair value recognition resulting from the purchase of minority interests in majority-owned LLCs	-	25,093	-	25,409
Interest expense, net	(2,015)	(2,149)	(6,157)	(6,152)
Net income	$3,639	$28,141	$19,339	$35,323
Basic earnings per share	$0.27	$2.18	$1.46	$2.74
Diluted earnings per share	$0.27	$2.18	$1.45	$2.74
Weighted average number of shares outstanding - Basic	13,298	12,911	13,289	12,887

Weighted average number of share equivalents	4	7	8	6
Weighted average number of shares and equivalents outstanding - Diluted	13,302	12,918	13,297	12,893

See accompanying notes to these condensed consolidated financial statements.

Universal Health Realty Income Trust

Condensed Consolidated Statements of Comprehensive Income

For the Three and Nine Months Ended September 30, 2015 and 2014

(dollar amounts in thousands, except per share amounts)

(unaudited)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2015	2014	2015	2014
Net Income	$3,639	$28,141	$19,339	$35,323
Other comprehensive income/(loss):				
Unrealized derivative (losses)/gains on interest rate caps	(15)	18	(94)	(74)
Amortization of interest rate cap fees	23	23	69	61
Total other comprehensive income/(loss):	8	41	(25)	(13)
Total comprehensive income	$3,647	$28,182	$19,314	$35,310

See accompanying notes to these condensed consolidated financial statements.

Universal Health Realty Income Trust

Condensed Consolidated Balance Sheets

(dollar amounts in thousands)

(unaudited)

	September 30, 2015	December 31, 2014
Assets:		
Real Estate Investments:		
Buildings and improvements	$ 468,566	$ 451,005
Accumulated depreciation	(117,054)	(106,480)
	351,512	344,525
Land	41,724	35,584
Net Real Estate Investments	393,236	380,109
Investments in limited liability companies ("LLCs"), net	7,811	8,605
Other Assets:		
Cash and cash equivalents	3,651	3,861
Base and bonus rent receivable from UHS	2,015	2,086
Rent receivable - other	4,414	4,219
Intangible assets (net of accumulated amortization of $24.0 million and $19.7 million at September 30, 2015 and December 31, 2014, respectively)	20,865	23,123
Deferred charges and other assets, net	6,660	6,863
Total Assets	$ 438,652	$ 428,866
Liabilities:		
Line of credit borrowings	$ 114,350	$ 89,750
Mortgage and other notes payable, non-recourse to us (including net debt premium of $354 and $523 at September 30, 2015 and December 31, 2014, respectively)	115,853	123,405
Accrued interest	470	545
Accrued expenses and other liabilities	5,806	8,522
Tenant reserves, escrows, deposits and prepaid rents	2,932	2,063
Total Liabilities	239,411	224,285
Equity:		
Preferred shares of beneficial interest, $.01 par value; 5,000,000 shares authorized; none issued and outstanding	-	-
Common shares, $.01 par value; 95,000,000 shares authorized; issued and outstanding: 2015 - 13,325,658;	133	133

2014 - 13,301,204		
Capital in excess of par value	241,675	240,835
Cumulative net income	550,934	531,595
Cumulative dividends	(593,388)	(567,894)
Accumulated other comprehensive loss	(113)	(88)
Total Equity	199,241	204,581
Total Liabilities and Equity	$ 438,652	$ 428,866

See accompanying notes to these condensed consolidated financial statements.

Universal Health Realty Income Trust

Condensed Consolidated Statement of Cash Flows

(dollar amounts in thousands)

(unaudited)

	Nine months ended September 30,	
	2015	2014
Cash flows from operating activities:		
Net income	$19,339	$35,323
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	16,884	14,922
Amortization of debt premium	(169)	(251)
Stock-based compensation expense	316	298
Gain on property exchange	(8,742)	-
Gains on purchase of minority interests in majority-owned LLCs	-	(25,409)
Changes in assets and liabilities:		
Rent receivable	(311)	(622)
Accrued expenses and other liabilities	(278)	(439)
Tenant reserves, escrows, deposits and prepaid rents	869	242
Accrued interest	(75)	(31)
Other, net	(533)	(144)
Net cash provided by operating activities	27,300	23,889
Cash flows from investing activities:		
Investments in LLCs	(418)	(1,243)
Cash distributions in excess of income from LLCs	168	1,011
Cash distribution of refinancing proceeds from LLCs	1,045	2,280
Additions to real estate investments, net	(3,667)	(2,033)
Cash received for property exchange	2,000	-
Net cash paid for acquisition of properties	(16,765)	(15,600)
Cash paid to acquire minority interests in majority-owned LLCs	(2,250)	(3,494)
Net cash used in investing activities	(19,887)	(19,079)
Cash flows from financing activities:		
Net borrowings on line of credit	24,600	26,750
Repayments of mortgages and other notes payable	(7,383)	(11,472)
Financing costs paid	(1,000)	-
Dividends paid	(25,494)	(24,341)
Partial settlement of dividend equivalent rights	(17)	-
Issuance of shares of beneficial interest, net	1,671	3,074
Net cash used in financing activities	(7,623)	(5,989)
Decrease in cash and cash equivalents	(210)	(1,179)
Increase in cash due to recording of LLCs on a consolidated basis	-	1,581
Cash and cash equivalents, beginning of period	3,861	3,337
Cash and cash equivalents, end of period	$3,651	$3,739

Supplemental disclosures of cash flow information:		
Interest paid	$6,052	$6,075
Supplemental disclosures of non-cash transactions:		
Consolidation of LLCs:		
Net real estate investments	$—	$84,064
Cash and cash equivalents	—	1,581
Intangible assets	—	6,490
Rent receivable - other	—	388
Deferred charges and other assets, net	—	100
Investment in LLCs	—	(28,616)
Mortgage and other notes payable, non-recourse to us	—	(29,758)

Accrued interest	—	(116)
Accrued expenses and other liabilities	—	(1,245)
Tenant reserves, escrows, deposits and prepaid rents	—	(485)
Note payable to previous third-party member	—	(3,500)
Gains on purchases of minority interests in majority-owned LLCs	—	(25,409)
Cash paid for purchase of minority interests in majority-owned LLCs	$—	$3,494
Property Exchange Transaction:		
Net assets acquired in property exchange	$9,886	$—
Net assets relinquished in property exchange	(3,144)	—

See accompanying notes to these condensed consolidated financial statements.

UNIVERSAL HEALTH REALTY INCOME TRUST

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

September 30, 2015

(unaudited)

(1) General

This Quarterly Report on Form 10-Q is for the quarter ended September 30, 2015. In this Quarterly Report, “we,” “us,” “our” and the “Trust” refer to Universal Health Realty Income Trust and its subsidiaries.

In this Quarterly Report on Form 10-Q, the term “revenues” does not include the revenues of the unconsolidated limited liability companies (“LLCs”) in which we have various non-controlling equity interests ranging from 33% to 95%. As of September 30, 2015, we had investments in five jointly-owned LLCs which own medical office buildings, all of which are accounted for by the equity method (see Note 5). These LLCs are included in our financial statements for all periods presented on an unconsolidated basis since they are not variable interest entities for which we are the primary beneficiary, nor do we hold a controlling voting interest.

The financial statements included herein have been prepared by us, without audit, pursuant to the rules and regulations of the SEC and reflect all normal and recurring adjustments which, in our opinion, are necessary to fairly present results for the interim periods. Certain information and footnote disclosures normally included in financial statements prepared in accordance with generally accepted accounting principles have been condensed or omitted pursuant to such rules and regulations, although we believe that the accompanying disclosures are adequate to make the information presented not misleading. It is suggested that these financial statements be read in conjunction with the financial statements, the notes thereto and accounting policies included in our Annual Report on Form 10-K for the year ended December 31, 2014.

(2) Relationship with Universal Health Services, Inc. (“UHS”) and Related Party Transactions

Leases: We commenced operations in 1986 by purchasing properties of certain subsidiaries from UHS and immediately leasing the properties back to the respective subsidiaries. Most of the leases were entered into at the time we commenced operations and provided for initial terms of 13 to 15 years with up to six additional 5-year renewal terms. The current base rentals and lease and rental terms for each facility are provided below. The base rents are paid monthly and each lease also provides for additional or bonus rents which are computed and paid on a quarterly basis based upon a computation that compares current quarter revenue to a corresponding quarter in the base year. These hospital leases with subsidiaries of UHS are unconditionally guaranteed by UHS and are cross-defaulted with one another.

The combined revenues generated from the leases on the UHS hospital facilities comprised approximately 25% and 27% of our consolidated revenues for the three months ended September 30, 2015 and 2014, respectively, and approximately 25% and 29% of our consolidated revenues for the nine months ended September 30, 2015 and 2014,

respectively. Including 100% of the revenues generated at the unconsolidated LLCs in which we have various non-controlling equity interests ranging from 33% to 95%, the leases on the UHS hospital facilities accounted for approximately 20% and 22% of the combined consolidated and unconsolidated revenue for the three months ended September 30, 2015 and 2014, respectively, and 20% and 22% of the combined consolidated and unconsolidated revenue for the nine months ended September 30, 2015 and 2014, respectively. In addition, thirteen medical office buildings ("MOBs") and two free-standing emergency departments ("FEDs"), that are either wholly or jointly-owned by us, include tenants which are subsidiaries of UHS.

Pursuant to the Master Lease Document by and among us and certain subsidiaries of UHS, dated December 24, 1986 (the "Master Lease"), which governs the leases of all hospital properties with subsidiaries of UHS, UHS has the option to renew the leases at the lease terms described below by providing notice to us at least 90 days prior to the termination of the then current term. UHS also has the right to purchase the respective leased facilities at the end of the lease terms or any renewal terms at the appraised fair market value. In addition, the Master Lease, as amended during 2006, includes a change of control provision whereby UHS has the right, upon one month's notice should a change of control of the Trust occur, to purchase any or all of the three leased hospital properties listed below at their appraised fair market value. Additionally, UHS has rights of first refusal to: (i) purchase the respective leased facilities during and for 180 days after the lease terms at the same price, terms and conditions of any third-party offer, or; (ii) renew the lease on the respective leased facility at the end of, and for 180 days after, the lease term at the same terms and conditions pursuant to any third-party offer.

During the third quarter of 2014, a wholly-owned subsidiary of UHS provided notification to us that, upon expiration of The Bridgeway's lease term which occurred in December, 2014, it intended to exercise its option to purchase the real property of the facility. Pursuant to the terms of the lease, we and the wholly-owned subsidiary of UHS were both required to obtain independent appraisals of the property to determine its fair market value. On December 31, 2014, The Bridgeway, a 103-bed behavioral health

facility located in North Little Rock, Arkansas, was sold to UHS for $17.3 million. During each of the three years ended December 31, 2014, our revenues, net cash provided by operating activities and funds from operations have included approximately $1.1 million earned annually in connection with The Bridgeway's lease.

The table below details the existing lease terms and renewal options for our three acute care hospitals operated by wholly-owned subsidiaries of UHS:

Hospital Name	Annual Minimum Rent	End of Lease Term	Renewal Term (years)	
McAllen Medical Center	$5,485,000	December, 2016	15	(a)
Wellington Regional Medical Center	$3,030,000	December, 2016	15	(b)
Southwest Healthcare System, Inland Valley Campus	$2,648,000	December, 2016	15	(b)

(a) UHS has three 5-year renewal options at existing lease rates (through 2031).
(b) UHS has one 5-year renewal option at existing lease rates (through 2021) and two 5-year renewal options at fair market value lease rates (2022 through 2031).

During the first quarter of 2015, we purchased from wholly-owned subsidiaries of UHS, the real property of two newly-constructed and recently opened FEDs located in Weslaco and Mission, Texas. Each FED consists of approximately 13,600 square feet and is operated by wholly-owned subsidiaries of UHS. In connection with these acquisitions, ten-year lease agreements with six, 5-year renewal terms have been executed with UHS for each FED. The first four, 5-year renewal terms (covering years 2025 through 2044) include 2% annual lease rate increases, computed on accumulative and compounded basis, and the last two, 5-year renewal terms (covering the years 2045 through 2054) will be at the then fair market value lease rates. These leases are cross-defaulted with one another. UHS has the option to purchase the leased properties upon the expiration of the fixed term and each five-year extended term at the fair market value at that time. The aggregate acquisition cost of these facilities was approximately $12.8 million, and the aggregate rental revenue earned by us at the commencement of the leases is approximately $900,000 annually.

Management cannot predict whether the leases with subsidiaries of UHS, which have renewal options at existing lease rates or fair market value lease rates, or any of our other leases, will be renewed at the end of their lease term. If the leases are not renewed at their current rates or the fair market value lease rates, we would be required to find other operators for those facilities and/or enter into leases on terms potentially less favorable to us than the current leases. In addition, if subsidiaries of UHS exercise their options to purchase the respective leased hospital and FED facilities upon expiration of the lease terms, our future revenues could decrease if we were unable to earn a favorable rate of return on the sale proceeds received, as compared to the rental revenue currently earned pursuant to these leases.

Advisory Agreement: UHS of Delaware, Inc. (the "Advisor"), a wholly-owned subsidiary of UHS, serves as Advisor to us under an Advisory Agreement (the "Advisory Agreement") dated December 24, 1986. Pursuant to the Advisory Agreement, the Advisor is obligated to present an investment program to us, to use its best efforts to obtain investments suitable for such program (although it is not obligated to present any particular investment opportunity to us), to provide administrative services to us and to conduct our day-to-day affairs. All transactions between us and UHS must be approved by the Trustees who are unaffiliated with UHS (the "Independent Trustees"). In performing its services under the Advisory Agreement, the Advisor may utilize independent professional services, including accounting, legal, tax and other services, for which the Advisor is reimbursed directly by us. The Advisory Agreement

may be terminated for any reason upon sixty days written notice by us or the Advisor. The Advisory Agreement expires on December 31 of each year; however, it is renewable by us, subject to a determination by the Independent Trustees, that the Advisor's performance has been satisfactory. In December of 2014, based upon a review of our advisory fee and other general and administrative expenses, as compared to an industry peer group, the Advisory agreement was renewed for 2015 pursuant to the same terms as the Advisory Agreement in place during 2014.

The average real estate assets for advisory fee calculation purposes exclude certain items from our consolidated balance sheet such as, among other things, accumulated depreciation, cash and cash equivalents, base and bonus rent receivables, deferred charges and other assets. The advisory fee is payable quarterly, subject to adjustment at year-end based upon our audited financial statements. In addition, the Advisor is entitled to an annual incentive fee equal to 20% of the amount by which cash available for distribution to shareholders for each year, as defined in the Advisory Agreement, exceeds 15% of our equity as shown on our consolidated balance sheet, determined in accordance with generally accepted accounting principles without reduction for return of capital dividends. The Advisory Agreement defines cash available for distribution to shareholders as net cash flow from operations less deductions for, among other things, amounts required to discharge our debt and liabilities and reserves for replacement and capital improvements to our properties and investments. No incentive fees were paid during the first nine months of 2015 or 2014 since the incentive fee requirements were not achieved. Advisory fees incurred and paid (or payable) to UHS amounted to $708,000 and $653,000 for the

three months ended September 30, 2015 and 2014, respectively, and were based upon average invested real estate assets of $405 million and $373 million for the three-month periods ended September 30, 2015 and 2014, respectively. Advisory fees incurred and paid (or payable) to UHS amounted to $2.1 million and $1.9 million for the nine months ended September 30, 2015 and 2014, respectively, and were based upon average invested real estate assets of $394 million and $359 million for the nine-month periods ended September 30, 2015 and 2014, respectively.

Officers and Employees: Our officers are all employees of a wholly-owned subsidiary of UHS and although as of September 30, 2015 we had no salaried employees, our officers do typically receive annual stock-based compensation awards in the form of restricted stock. In special circumstances, if warranted and deemed appropriate by the Compensation Committee of the Board of Trustees, our officers may also receive one-time special compensation awards in the form of restricted stock and/or cash bonuses.

Share Ownership: As of September 30, 2015 and December 31, 2014, UHS owned 5.9% of our outstanding shares of beneficial interest.

SEC reporting requirements of UHS: UHS is subject to the reporting requirements of the SEC and is required to file annual reports containing audited financial information and quarterly reports containing unaudited financial information. Since the leases on the hospital facilities leased to wholly-owned subsidiaries of UHS comprised approximately 25% and 27% of our consolidated revenues during the three month periods ended September 30, 2015 and 2014, respectively, and comprised approximately 25% and 29% of our consolidated revenues during the nine months ended September 30, 2015 and 2014, respectively, and since a subsidiary of UHS is our Advisor, you are encouraged to obtain the publicly available filings for Universal Health Services, Inc. from the SEC’s website. These filings are the sole responsibility of UHS and are not incorporated by reference herein.

(3) Dividends and Equity Issuance Program

Dividends:

We declared and paid dividends of $8.5 million, or $.640 per share, during the third quarter of 2015 and $8.1 million, or $.630 per share, during the third quarter of 2014. We declared and paid dividends of $25.5 million, or $1.915 per share, during the nine-month period ended September 30, 2015 and $24.3 million, or $1.885 per share, during the nine-month period ended September 30, 2014.

Equity Issuance Program:

During the fourth quarter of 2013, we commenced an at-the-market (“ATM”) equity issuance program, pursuant to the terms of which we may sell, from time-to-time, common shares of our beneficial interest up to an aggregate sales price of $50 million to or through Merrill Lynch, Pierce, Fenner and Smith, Incorporated (“Merrill Lynch”), as sales agent and/or principal. The common shares will be offered pursuant to the Registration Statement filed with the Securities and Exchange Commission, which became effective in November, 2012.

There were no shares issued pursuant to the ATM program during the first nine months of 2015. Since inception of this ATM program, we have issued 580,900 shares at an average price of $45.97 per share, which generated approximately $25.6 million of net proceeds (net of approximately $1.1 million, consisting of compensation of $667,000 to Merrill Lynch as well as $391,000 of other various fees and expenses). Included in the above was

approximately $1.1 million of the net cash proceeds (net of approximately $29,000 of compensation to Merrill Lynch) related to shares issued in late December, 2014 which were received by us during the first quarter of 2015.

(4) Property Exchange Transaction and Acquisitions

Nine Months Ended September 30, 2015:

Property Exchange Transaction:

In May, 2015, in exchange for the real property of Sheffield Medical Building ("Sheffield"), a 73,446 square foot medical office building ("MOB") located in Atlanta, Georgia, we received $2 million in cash and the real property of two MOBs located in Sandy Springs and Vinings, Georgia, from an unrelated third party. In connection with the two MOBs acquired in this transaction, triple net, master lease agreements applicable to 100% of the combined 36,700 rentable square feet of these properties have been executed with the counterparty. These master lease agreements have initial terms of 15 years and provide for 3% annual rent increases. We recorded an $8.7 million gain which is included in our Condensed Consolidated Statements of Income for the nine-months ended September 30, 2015, representing the difference between recorded net book value of Sheffield and the fair values of the properties exchanged, combined with the cash proceeds received.

Acquisitions:

In February, 2015, we purchased the Haas Medical Office Park, two single story buildings having an aggregate of approximately 16,000 rentable square feet, located in Ottumwa, Iowa, for approximately $4.1 million.

In January and February of 2015, we purchased from wholly-owned subsidiaries of UHS, the real property of two newly-constructed and recently opened FEDs located in Weslaco and Mission, Texas, for an aggregate acquisition cost of approximately $12.8 million. Each FED consists of approximately 13,600 square feet and is operated by wholly-owned subsidiaries of UHS. In connection with these acquisitions, ten-year lease agreements with six 5-year renewal terms have been executed with UHS for each FED. In connection with the lease agreements, the lessee shall have the option to purchase the leased property upon the expiration of the fixed term and each five-year extended term at the fair market value at that time.

Nine Months Ended September 30, 2014:

Acquisitions:

On August 27, 2014, we purchased the Hanover Emergency Center, a 22,000 rentable square feet, free-standing, full service emergency and imaging center, located in Mechanicsville, VA, for approximately $8.6 million. The single-tenant property is occupied pursuant to the terms of a 10-year lease with HCA Health Services of Virginia, Inc.

Effective August 1, 2014, we paid an aggregate of $6.8 million to purchase the minority ownership interests held by third-party members in six LLCs (as noted in the table below) in which we previously held various noncontrolling, majority ownership interests ranging from 85% to 95%. As a result of these minority ownership purchases, we now own 100% of each of these LLCs, which own medical office buildings and a clinic, and began accounting for each on a consolidated basis effective August 1, 2014. Pursuant to current accounting standards, during the third quarter of 2014, we were required to record each property’s assets and liabilities at their fair values which resulted in the recording of a $25.1 million non-cash gain, which is included in our Condensed Consolidated Statement of Income for the three and nine months ended September 30, 2014, representing the difference between the fair values and the equity method carrying value of each investment. Other than the increased depreciation and amortization expense resulting from the amortization of the intangible assets recorded in connection with these transactions, there was no material impact on our net income as a result of the consolidation of these LLCs.

Name of LLC/LP	Ownership prior to minority interest purchase		Property Owned by LLC
DVMC Properties	90	%	Desert Valley Medical Center
Santa Fe Scottsdale	90	%	Santa Fe Professional Plaza
PCH Medical Properties	85	%	Rosenberg Children’s Medical Plaza
Sierra Medical Properties	95	%	Sierra San Antonio Medical Plaza
PCH Southern Properties	95	%	Phoenix Children’s East Valley Care Center
3811 Bell Medical Properties	95	%	North Valley Medical Plaza

In January, 2014, we paid an aggregate of $7.2 million to purchase the following in a single transaction:

- The Children's Clinic at Springdale – a 9,800 square foot, single-tenant medical office building located in Springdale, Arkansas, and;
- The Northwest Medical Center at Sugar Creek – a 16,700 square foot, multi-tenant medical office building located in Bentonville, Arkansas.

Additionally, effective January 1, 2014, we paid an aggregate of $170,000 to purchase the 5% minority ownership interests held by third-party members in two LLCs in which we previously held noncontrolling, 95% majority ownership interests (Palmdale Medical Properties and Sparks Medical Properties). As a result of these minority ownership purchases, we now own 100% of each of these LLCs and began accounting for each property on a consolidated basis effective January 1, 2014. Pursuant to accounting standards, during the first quarter of 2014, we were required to record each property's assets and liabilities at their fair values which resulted in the recording of a $316,000 non-cash gain, which is included in our Condensed Consolidated Statement of Income for the nine months ended September 30, 2014, representing the difference between the fair values and the equity method carrying value of each investment. Other than the increased depreciation and amortization expense resulting from the amortization of the intangible assets recorded in connection with these transactions, there was no material impact on our net income as a result of the consolidation of these LLCs.

(5) Summarized Financial Information of Equity Affiliates

In accordance with the Financial Accounting Standards Board's ("FASB") standards and guidance relating to accounting for investments and real estate ventures, we account for our unconsolidated investments in LLCs which we do not control using the equity method of accounting. The third-party members in these investments have equal voting rights with regards to issues such as, but not limited to: (i) divestiture of property; (ii) annual budget approval, and; (iii) financing commitments. These investments, which represent 33% to 95% non-controlling ownership interests, are recorded initially at our cost and subsequently adjusted for our net equity in the net income, cash contributions to, and distributions from, the investments. Pursuant to certain agreements, allocations of sales proceeds and profits and losses of some of the LLC investments may be allocated disproportionately as compared to ownership interests after specified preferred return rate thresholds have been satisfied.

At September 30, 2015, we have non-controlling equity investments or commitments in five jointly-owned LLCs which own MOBs. We accounted for these LLCs on an unconsolidated basis pursuant to the equity method since they are not variable interest entities. The majority of these LLCs are joint-ventures between us and non-related parties that manage and hold minority ownership interests in the entities. Each LLC is generally self-sustained from a cash flow perspective and generates sufficient cash flow to meet its operating cash flow requirements and service the third-party debt (if applicable) that is non-recourse to us. Although there is typically no ongoing financial support required from us to these entities since they are cash-flow sufficient, we may, from time to time, provide funding for certain purposes such as, but not limited to, significant capital expenditures, leasehold improvements and debt financing. Although we are not obligated to do so, if approved by us at our sole discretion, additional cash fundings are typically advanced as equity or member loans. These LLCs maintain property insurance on the properties.

The following property table represents the five LLCs in which we own a noncontrolling interest and were accounted for under the equity method as of September 30, 2015 and December 31, 2014:

Name of LLC/LP	Ownership		Property Owned by LLC
Suburban Properties	33	%	Suburban Medical Plaza II
Brunswick Associates (a.)	74	%	Mid Coast Hospital MOB
Arlington Medical Properties (b.)	75	%	Saint Mary's Professional Office Building
Grayson Properties (c.)	95	%	Texoma Medical Plaza
FTX MOB Phase II (d.)	95	%	Forney Medical Plaza II

(a.) This LLC has a third-party term loan, which is non-recourse to us, of $8.8 million outstanding as of September 30, 2015.

(b.) We have funded $5.2 million in equity as of September 30, 2015 and are committed to invest an additional $1.2 million. This LLC had a third-party term loan, which was non-recourse to us, of $22.7 million, outstanding as of September 30, 2015. In October, 2015, we borrowed an additional $22.8 million under our Credit Agreement to repay this outstanding third-party mortgage loan on its scheduled maturity date. These funds were advanced as a member loan to Arlington Medical Properties, LLC pursuant to a short-term, 5.29% fixed rate note with a scheduled maturity date of April 10, 2016.

(c.)

We have funded $2.7 million in equity as of September 30, 2015, and are committed to fund an additional $300,000. This building is on the campus of a UHS hospital and has tenants that include subsidiaries of UHS. This LLC has a third-party term loan, which is non-recourse to us, of $14.7 million outstanding as of September 30, 2015.

(d.) We have committed to invest up to $2.5 million in equity and debt financing, of which $1.5 million has been funded as of September 30, 2015. This LLC has a third-party term loan, which is non-recourse to us, of $5.5 million outstanding as of September 30, 2015.

Effective August 1, 2014, we purchased the minority ownership interests, ranging from 5% to 15%, held by third-party members in six LLCs in which we previously held noncontrolling majority ownership interests, as noted in the table below. As a result of these minority ownership purchases, we now own 100% of each of these LLCs and began to account for them on a consolidated basis effective August 1, 2014. Prior to August 1, 2014, these LLCs were accounted for on an unconsolidated basis pursuant to the equity method.

Name of LLC/LP	Ownership prior to minority interest purchase		Property Owned by LLC
DVMC Properties	90	%	Desert Valley Medical Center
Santa Fe Scottsdale	90	%	Santa Fe Professional Plaza
PCH Medical Properties	85	%	Rosenberg Children’s Medical Plaza
Sierra Medical Properties	95	%	Sierra San Antonio Medical Plaza
PCH Southern Properties	95	%	Phoenix Children’s East Valley Care Center
3811 Bell Medical Properties	95	%	North Valley Medical Plaza

Below are the condensed combined statements of income (unaudited) for the LLCs accounted for under the equity method at September 30, 2015 and 2014. The data for the three months ended September 30, 2014, includes the financial results for the six above-mentioned LLCs that we began to account for on a consolidated basis as of August 1, 2014, as discussed above, for the one-month period ended July 31, 2014 (during which they were accounted for under the equity method). The data for the nine months ended September 30, 2014, includes the financial results for the six above-mentioned LLCs for the seven month period of January through July, 2014 (during which they were accounted for under the equity method).

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2015	2014 (b.)	2015	2014 (b.)
	(amounts in thousands)			
Revenues	$3,638	$3,905	$10,799	$13,828
Operating expenses	1,461	1,691	4,194	5,826
Depreciation and amortization	634	626	1,788	2,401
Interest, net	656	862	1,907	3,541
Net income	$887	$726	$2,910	$2,060

Our share of net income (a.)	$561	$499	$1,826	$1,771

(a.) Our share of net income for the three and nine months ended September 30, 2014 includes interest income earned by us on various advances made to LLCs of approximately $122,000 and $834,000, respectively. There were no advances outstanding during the first nine months of 2015, therefore there was no interest income earned by us for the three or nine months ended September 30, 2015.

(b.) As mentioned above, we began to account for six LLCs on a consolidated basis as of August 1, 2014. Prior to August 1, 2014, the financial results of these entities were accounted for under the equity method on an unconsolidated basis. The three months ended September 30, 2014, include the financial results of the six mentioned LLCs for one month ended July 31, 2014 and the nine months ended September 30, 2014, include the financial results of the six mentioned LLCs for seven months ended July 31, 2014.

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Below are the condensed combined balance sheets (unaudited) for the five above-mentioned LLCs in which we hold noncontrolling ownership interests and that were accounted for under the equity method as of September 30, 2015 and December 31, 2014:

	September 30, 2015	December 31, 2014
	(amounts in thousands)	
Net property, including CIP	$61,625	$ 62,450
Other assets	5,608	7,367
Total assets	$67,233	$ 69,817
Liabilities	$2,686	$ 3,348
Mortgage notes payable, non-recourse to us	51,707	52,728
Equity	12,840	13,741
Total liabilities and equity	$67,233	$ 69,817
Our share of equity in LLCs	$7,811	$ 8,605

As of September 30, 2015, and December 31, 2014, aggregate principal amounts due on mortgage notes payable by unconsolidated LLCs, which are accounted for under the equity method and are non-recourse to us, are as follows (amounts in thousands):

	Mortgage Loan Balance (a.)		
Name of LLC	9/30/2015	12/31/2014	Maturity Date
Arlington Medical Properties (b.)	$22,685	$ 23,287	October, 2015
FTX MOB Phase II	5,458	5,548	August, 2017
Grayson Properties	14,725	14,893	September, 2021
Brunswick Associates	8,839	9,000	December, 2024
	$51,707	$ 52,728	

(a.) All mortgage loans, other than construction loans, require monthly principal payments through maturity and include a balloon principal payment upon maturity.

(b.) In October, 2015, we borrowed an additional $22.8 million under our Credit Agreement to repay this outstanding third-party mortgage loan on its scheduled maturity date. These funds were advanced as a member loan to Arlington Medical Properties, LLC pursuant to a short-term, 5.29% fixed rate note with a scheduled maturity date of April 10, 2016.

Pursuant to the operating and/or partnership agreements of most of the five LLCs in which we continue to hold non-controlling majority ownership interests, the third-party member and the Trust, at any time, have the right to make an offer (“Offering Member”) to the other member(s) (“Non-Offering Member”) in which it either agrees to: (i) sell the entire ownership interest of the Offering Member to the Non-Offering Member (“Offer to Sell”) at a price as determined by the Offering Member (“Transfer Price”), or; (ii) purchase the entire ownership interest of the Non-Offering Member (“Offer to Purchase”) at the equivalent proportionate Transfer Price. The Non-Offering Member has 60 to 90 days to either: (i) purchase the entire ownership interest of the Offering Member at the Transfer Price, or;

(ii) sell its entire ownership interest to the Offering Member at the equivalent proportionate Transfer Price. The closing of the transfer must occur within 60 to 90 days of the acceptance by the Non-Offering Member.

(6) Recent Accounting Pronouncements

In April 2015, the Financial Accounting Standards Board ("FASB") issued an update to the accounting standard relating to the presentation of debt issuance costs. Under the new guidance, debt issuance costs related to a recognized debt liability will be presented on the balance sheet as a direct deduction from the debt liability. This amendment becomes effective for annual periods beginning on or after December 15, 2015, and interim periods beginning on or after December 15, 2015; however, early adoption is permitted. We do not expect the adoption of this guidance to have a material impact on our condensed consolidated financial statements.

In February 2015, the FASB issued ASU 2015-02, Amendments to the Consolidation Analysis, which amends the consolidation requirements in Accounting Standards Codification ("ASC") 810, Consolidation. ASU 2015-02 makes targeted amendments to the current consolidation guidance, which could change consolidation conclusions. This guidance will be effective for us beginning in our first quarter of 2016 and early adoption is permitted. We do not expect the adoption of this guidance to have a material impact on our condensed consolidated financial statements.

(7) Debt and Financial Instruments

Debt:

Management routinely monitors and analyzes the Trust's capital structure in an effort to maintain the targeted balance among capital resources including the level of borrowings pursuant to our $185 million revolving credit facility, the level of borrowings pursuant to non-course mortgage debt secured by the real property of our properties and our level of equity including consideration of additional equity issuances pursuant to our $50 million at-the-market equity issuance program. This ongoing analysis considers factors such as the current debt market and interest rate environment, the current/projected occupancy and financial performance of our properties, the current loan-to-value ratio of our properties, the Trust's current stock price, the capital resources required for anticipated acquisitions and the expected capital to be generated by anticipated divestitures. This analysis, together with consideration of the Trust's current balance of revolving credit facility borrowings, non-recourse mortgage borrowings and equity, assists management in deciding which capital resource to utilize when events such as refinancing of specific debt components occur or additional funds are required to finance the Trust's growth.

On March 27, 2015, we entered into a new $185 million revolving credit agreement ("Credit Agreement"). The Credit Agreement, which will mature in four years, replaced our previous revolving credit facility which was scheduled to mature on July 24, 2015. The Credit Agreement includes a $50 million sub limit for letters of credit and a $20 million sub limit for swingline/short-term loans. The Credit Agreement also provides a one-time option to extend the maturity date for an additional one year period, and an option to increase the total facility borrowing capacity up to an additional $50 million, subject to lender agreement. Borrowings under the new facility are guaranteed by certain subsidiaries of the Trust. In addition, borrowings under the new facility are secured by first priority security interests in and liens on all equity interests in the Trust's wholly-owned subsidiaries. Borrowings made pursuant to the Credit Agreement will bear interest, at our option, at one, two, three, or six month LIBOR plus an applicable margin ranging from 1.50% to 2.00% or at the Base Rate plus an applicable margin ranging from 0.50% to 1.00%. The Credit Agreement defines "Base Rate" as the greatest of: (a) the administrative agent's prime rate; (b) the federal funds effective rate plus 1/2 of 1%, and; (c) one month LIBOR plus 1%. A commitment fee of 0.20% to 0.40% (depending on our total leverage ratio) will be charged on the average unused portion of the revolving credit commitments. The margins over LIBOR, Base Rate and the commitment fee are based upon our ratio of debt to total capital. At September 30, 2015, the applicable margin over the LIBOR rate was 1.625%, the margin over the Base Rate was 0.625%, and the commitment fee was 0.25%.

At September 30, 2015, we had $114.4 million of outstanding borrowings and $5.2 million of letters of credit outstanding against our revolving credit agreement. We had $65.5 million of available borrowing capacity, net of the outstanding borrowings and letters of credit outstanding as of September 30, 2015. At December 31, 2014, we had $89.8 million of outstanding borrowings and $6.3 million of letters of credit outstanding against our previous $150 million revolving credit agreement (which was replaced in March, 2015, as discussed above). We had $54.0 million of available borrowing capacity, net of the outstanding borrowings and letters of credit outstanding as of December 31, 2014. There are no compensating balance requirements.

In October, 2015, we borrowed an additional $22.8 million under our Credit Agreement to repay the outstanding third-party mortgage loan on the Saint Mary's Professional Office Building (owned by Arlington Medical Properties, LLC in which we hold a 75% noncontrolling ownership interest) on its scheduled maturity date. These funds were advanced as a member loan to Arlington Medical Properties, LLC pursuant to a short-term, 5.29% fixed rate note with a scheduled maturity date of April 10, 2016.

The Credit Agreement contains customary affirmative and negative covenants, including limitations on certain indebtedness, liens, acquisitions and other investments, fundamental changes, asset dispositions and dividends and

other distributions. The Credit Agreement also contains restrictive covenants regarding the Trust's ratio of total debt to total assets, the fixed charge coverage ratio, the ratio of total secured debt to total asset value, the ratio of total unsecured debt to total unencumbered asset value, and minimum net worth, as well as customary events of default, the occurrence of which may trigger an acceleration of amounts outstanding under the Credit Agreement. We are in compliance with all of the covenants at September 30, 2015. We also believe that we would remain in compliance if the full amount of our commitment was borrowed.

The following table includes a summary of the required compliance ratios, giving effect to the covenants contained in the Credit Agreement (dollar amounts in thousands):

	Covenant	September 30, 2015	
Tangible net worth	$125,000	$ 178,376	
Total leverage	< 60%	44.2	%
Secured leverage	< 30%	20.8	%
Unencumbered leverage	< 60%	35.3	%
Fixed charge coverage	> 1.50x	3.2x	

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We have fifteen mortgages, all of which are non-recourse to us, included on our condensed consolidated balance sheet as of September 30, 2015, with a combined outstanding balance of $115.5 million (excluding net debt premium of $354,000 at September 30, 2015). The following table summarizes our outstanding mortgages, excluding net debt premium, at September 30, 2015 (amounts in thousands):

Facility Name	Outstanding Balance (in thousands)(a.)	Interest Rate	Maturity Date
Desert Valley Medical Center floating rate mortgage loan (b.)	$ 3,777	3.45 %	October, 2015
Palmdale Medical Plaza fixed rate mortgage loan (c.)	5,892	3.69 %	October, 2015
Summerlin Hospital Medical Office Building III floating rate mortgage loan	10,779	3.45 %	December, 2016
Peace Health fixed rate mortgage loan	20,909	5.64 %	April, 2017
Auburn Medical II floating rate mortgage loan	7,012	2.95 %	April, 2017
Medical Center of Western Connecticut fixed rate mortgage loan	4,694	6.00 %	June, 2017
Summerlin Hospital Medical Office Building II fixed rate mortgage loan	11,498	5.50 %	October, 2017
Phoenix Children's East Valley Care Center fixed rate mortgage loan	6,383		